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IN THE

Supreme Court of the United States

No. 764 . October Term, 1944.

BUDD INTERNATIONAL CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF.

HENRY S. DRINKER,
FREDERICK E. S. MORRISON,
JOHN W. BODINE,
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BUDD INTERNATIONAL CORPORATION,
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v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioner, Budd International Corporation, prays that a writ of certiorari issue to the United States Circuit Court of Appeals for the Third Circuit, which affirmed the decision of the Tax Court sustaining respondent in denying to petitioner the right, in figuring Income and Undistributed Profits Tax for 1936 on the sale of a capital asset, to determine the cost of such asset by reference to its fair market value when acquired by petitioner and in not holding that petitioner was not subject to Undistributed Profits Tax in connection with the profit on such sale, despite the fact that petitioner had disbursed practically the entire profit from such transaction, together with all its other liquid funds, in expenses, dividends and the redemption of its preferred stock prior to the proposal of the Undistributed Profits Tax to Congress by the President.

OPINIONS BELOW.

The original opinion and judgment of the Circuit Court of Appeals and its opinion on rehearing are reported at 143 F. 2d 784 (R. 540, 554, 563). The opinion of the Tax Court (R. 495a-552a) is reported in 45 B. T. A. 737.

JURISDICTION.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925 (43 Stat. 938, U. S. C. Title 28, section 347) and Section 1141 (a) of the Internal Revenue Code, which authorizes this Court to grant the writ "either before or after a judgment or decree by such lower court."

The Judgment of the United States Circuit Court of Appeals to be reviewed was entered, after reargument, on July 17, 1944 (No. 8071, October Term, 1943). The period allowed for filing the present petition was, on October 11, 1944, extended by order signed by Mr. Justice Roberts to and including December 16, 1944 (R. 571).

QUESTIONS PRESENTED.

1. When a block of stock of a newly organized corporation is issued in exchange for several items of property, without any agreed apportionment of a specific number of shares to any of such items, and where there is no market in the stock and its fair market value cannot be thus measured, may the value of the shares issued in exchange for an item of such property subsequently sold at a profit be measured, in order to fix the basis of such property for the purpose of reckoning the taxable gain, by the fair market value, at the time of the exchange, of the property for which such shares were issued?

2. Where preferred stock of a corporation was issued prior to May 1, 1936, and the terms and conditions embodied in the stock certificate prohibited any dividends or

distributions to the common stock while dividends and sinking fund payments for the preferred stock are in arrears, did this certificate constitute a contract restricting the payment of dividends so as to give rise to a credit against the Undistributed Profits Tax under section 26 (c) of the Revenue Act of 1936?

3. Where a corporation redeems at $57 per share preferred stock which has dividends accrued and unpaid at the rate of $12.25 per share, the corporation at the time having an earned surplus in excess of the aggregate accrued dividends on all the stock so redeemed, was this equivalent, as to the $12.25 per share, to the payment of a taxable dividend, for the purpose of computing dividend paid credit against the Undistributed Profits Tax?

4. Under the facts as found by the Tax Court, was petitioner entitled to a credit against Undistributed Profits Tax on account of the sums paid in redemption of its preferred stock, by virtue of the Amendment by Section 501 of the Revenue Act of 1942 (Public Law 753, 77th Cong. 2nd Sess.) which added Section 26 (g) to the Revenue Act of 1936?

5. Would the subjection of a corporation to Undistributed Profits Tax on the gain from the sale of a capital asset prior to March 1, 1936, amount to a deprivation of the corporation's property without due process of law, where the entire amount of such gain, including all disbursable assets of the corporation, were distributed in redemption of the corporation's preferred stock with accrued dividends prior to March 3, 1936, the date when the President of the United States first recommended the enactment of the Undistributed Profits Tax to Congress?

STATUTES INVOLVED.

The pertinent provisions of the Internal Revenue Code and of the Revenue Acts of 1936 and 1942 are set forth in the Appendix.

STATEMENT.

In 1926 Edward G. Budd Manufacturing Company, a Pennsylvania corporation (hereafter called Manufacturing Company) organized Pressed Steel Company of Great Britain, and acquired 64% of the latter's common shares at a stipulated cost to it of $1,000,000, and also certain preference shares at a cost not here material. By 1930 the common shares had greatly increased in value.

In September, 1930, Manufacturing Company, together with Schroder & Company, London bankers, organized petitioner, Budd International Corporation, pursuant to an agreement between them made in April, 1930. The total stock issued by petitioner to them both was 76,572 shares of preferred stock and 436,572 shares of common stock. Schroder & Company contributed $3,000,025 and received 68,572 shares of preferred and 68,572 shares of common stock. Manufacturing Company, in addition to $344,458.01 of cash, contributed its Pressed Steel common and preferred shares, the majority of the stock of Ambi-Budd Presswerk, a German company, as well as certain license agreements, agreed to assign all future patents for use in Europe and to help train the working force of the new company, and further agreed to guarantee the dividends on petitioner's preferred stock (89% of which was issued to Schroder as above). For these stocks, contracts and cash, Manufacturing Company received 368,000 shares (84%) of petitioner's common stock and 8,000 shares (11%) of its preferred.

By 1936 the dividends on petitioner's preferred stock were more than three years in arrears, giving the preferred holders the right to voting control of petitioner.

In February, 1936, petitioner sold the Pressed Steel common shares to Schroder and British Pacific Trust, Ltd., for about $5,600,000. In the negotiations for this sale Schroder, as the holder of 89% of the preferred stock and hence in control of petitioner, "insisted" (as found by the Board) "on the retirement of its shares of petitioner's

preferred as a condition of any trade with it." Accordingly, on the completion of the deal the proceeds of the sale were first applied to retire Schroder's 68,572 shares of preferred stock with its accrued dividends, in a total of $57 per share, to the amount of $3,908,604. After deducting the amount to retire at $57 per share the 8,000 shares of preferred stock hold by Manufacturing Company, the expenses of the sale and a reserve for taxes (other than Undistributed Profits Tax, which at that time had not been enacted), petitioner had left $655,286.34, with which it paid a common dividend of $654,858, and had left on March 6, 1936, but $428.34, and had no other assets on which it could realize a substantial amount of cash.

After the entire transaction had been completed and the proceeds of sale distributed as above, Congress, on June 22, 1936, passed an amendment to the Revenue Act imposing an Undistributed Profits Tax on corporations failing to distribute their earnings in dividends.

The Board of Tax Appeals (now the Tax Court) held the petitioner liable to Income and Undistributed Profits Tax for 1936 to the amount of $582,202.42, with interest, in addition to the 1936 Income Tax already paid of $633,844.76. The Tax Court held that the petitioner's payment of $3,908,604 in redemption of its preferred stock plus accrued dividends did not reduce petitioner's earnings and profits, (which the Undistributed Profits Tax Act was aimed to penalize if not distributed to the holders of the common stock), despite the fact that when that Act was first proposed and passed petitioner had left no distributable funds to distribute.

The Tax Court held:

(1) That although the organization of petitioner in 1930 was probably not such a transaction as required petitioner under Section 112 (b) (5) of the Revenue Act to use its transferor's basis in reckoning the profit from the subsequent sale of the Pressed Steel stock, nevertheless peti-

tioner had not adequately proved the cost to it of such shares in 1930.

(2) That the provisions in petitioner's preferred stock certificates prohibiting dividends on its common shares while preferred dividends were in arrears did not constitute a written contract restricting dividends as to give rise to a credit under Section 26 of the Act of 1936, imposing the Undistributed Profits Tax.

(3) That the payment of that part of the amount paid in redemption of petitioner's preferred stock which represented the $12.25 per share of accumulated unpaid dividends thereon was not equivalent to the payment of a taxable dividend, giving rise to a dividend paid credit in reckoning Undistributed Profits Tax.

After the decision by the Tax Court (Nov. 19, 1941) and after the present petitioner had filed a petition for review to the Circuit Court of Appeals for the Third Circuit, Congress (after representations to the House and Senate Committees by this petitioner) passed the 1942 Amendment to section 26 of the Undistributed Profits Tax allowing retroactively an additional credit for that part of the gain from the sale of a capital asset prior to March 3, 1936, which, pursuant to a contract, was distributed to stockholders in redemption in whole or in part of preferred stock (for text see Appendix hereto p. 31).

The Circuit Court of Appeals originally refused respondent's motion to remand the case to the Tax Court for findings relative to the applicability of the amendment of 1942, but after argument and subsequently reargument on the case, held:—

(1) That on the organization of petitioner in 1930, Schroder and the Manufacturing Company did not receive stock in substantially the same proportions as they contributed property and therefore the basis of the petitioner in reckoning Income and Undistributed Profits Tax on the gain from the sale of the Pressed Steel stock was the cost

of such stock to petitioner in 1930 and not the cost of said stock to petitioner's transferor, the Manufacturing Company, in 1936.

(2) That petitioner had not adequately proved the cost to it of the Pressed Steel stock in 1930 (this holding is the primary basis of the present petition for certiorari).

(3) That although the provisions in petitioner's preferred stock certificate constituted a contract restricting the payment of dividends insofar as they required petitioner to set up a sinking fund for preferred stock, they did not constitute such a contract insofar as they prohibited dividends on common stock while preferred dividends were in arrears, so as to give rise to a credit under section 26 (c) of the Undistributed Profits Tax Act of 1936.

(4) The Circuit Court of Appeals did not pass on the question as to whether that part of the payment in redemption of preferred stock which represented accrued dividends was equivalent to the payment of a taxable dividend, giving rise to a dividend paid credit.

(5) The Circuit Court of Appeals remanded the case to the Tax Court for a finding as to whether the redemption of the preferred stock was "pursuant to a contract" within the meaning of the amendment of 1942.

Although the present petition is filed prior to a final disposition of the whole case by the Court below, that Court's decision of points (2) and (3) above against petitioner will, apparently, be final as to petitioner, provided the Tax Court makes a finding in petitioner's favor on the question for which the case is remanded. Accordingly, the petitioner's only opportunity to have the decision of the Circuit Court of Appeals reviewed on these points is by petition for certiorari filed at the present time.

The two questions of law decided against petitioner by the Circuit Court of Appeals as above, are:

(1) Whether the cost to petitioner of the Pressed Steel common shares in 1930 (which cost the Court below held was petitioner's basis for computing gain) may be approved as equal to the then fair market value ($3,000,000) of those shares, there being no market for, and, thus, no measure of the value of the new stock petitioner issued for those shares; or, whether the cost of the Pressed Steel shares to petitioner in 1930 must be taken to be equal to the cost thereof to Manufacturing Company in 1926 ($1,000,000).

(2) Whether, for the purpose of calculating Undistributed Profits Tax, petitioner was entitled to a credit for the amount paid (both principal and accrued dividends) to redeem its preferred stock, this latter question arising both under section 26 of the Revenue Act of 1936 allowing credits where the payment of dividends was precluded by a contract, and under the retroactive amendment to Section 26, contained in Section 501 (a) (3) of the new Act of 1942 providing, by adding paragraph (g) to Section 26, a credit for amounts paid to redeem stock prior to March 3, 1936, pursuant to a contract.

These two questions of law, although both of great importance in the administration of the Federal Income Tax Law, were neither of them questions within the peculiar knowledge and experience of the Tax Court.

On the first question, both Courts held that, although petitioner had proved *the fair market value of the Pressed Steel shares* at the time of their transfer to petitioner in 1930, this was no evidence of their cost to petitioner, which was the then *fair market value of the shares of petitioner's stock* issued in exchange for them.

On the second point, both Courts held that the provisions of petitioner's preferred stock certificate, prohibiting common dividends when preferred dividends were in arrears, were not such a written contract as to form the basis of a credit under section 26 of the Act of 1936.

The question as to the applicability of the Amendment of 1942 was not passed on by the Tax Court, since its decision in this case was rendered and appeal taken to the Circuit Court of Appeals prior to the passage of the 1942 Amendment. The latter Court held the Amendment applicable even though the contract to apply the 1936 profits to the redemption of the preferred stock was partly or wholly oral. The Circuit Court, however, remanded the case to the Tax Court for a specific finding as to the existence of a contract, despite the fact that the uncontradicted testimony showed that there was such a contract and of the further fact that the Amendment of 1942 was drafted and passed on the presentation to the Committees of the House and Senate of the opinion of the Tax Court in this very case. The Amendment was clearly designed by Congress to remedy the gross injustice which would result from subjecting this particular corporation to a penal tax for not distributing to its common stockholders dividends from profits which it had already completely disbursed to its preferred stockholders prior to the date when the President first proposed the Undistributed Profits Tax to Congress on March 3, 1936.

SPECIFICATION OF ERRORS TO BE URGED.

The Circuit Court of Appeals erred:

1. In holding that proof of the 1930 fair value of the Pressed Steel shares was insufficient to show the then fair value of the shares of petitioner's stock then issued in exchange for them.

2. In holding that the terms and conditions embodied in the certificates of petitioner's preferred stock did not constitute a contract restricting the payment of dividends on the common stock while preferred dividends were in arrears, so as to give rise to a credit against Undistributed Profits Tax under Section 26 of the Revenue Act of 1936.

3. In failing to hold that the sum of $12.25 per share of the amount paid for the redemption of 68,572 shares of

petitioner's preferred stock was not equivalent to a taxable dividend and consequently did not give rise to a credit in reckoning Undistributed Profits Tax.

4. In failing to hold, under the facts as already found by the Tax Court, that petitioner was entitled, pursuant to the 1942 Amendment to Section 26 of the Revenue Act, to a credit for the amount paid its preferred stockholders in redemption of their stock.

5. In failing to hold as a matter of law that petitioner was not subject to undistributed profits tax for 1936.

REASONS FOR GRANTING THE WRIT.

I. This Case Raises an Important Question of Federal Tax Law, on Which the Decision of the Court Below Is in Direct Conflict With That of the 10th Circuit in Another Case, Which Question Has Not Been But Should Be Settled by This Court.

In *Commissioner v. McKinney*, 87 F. (2d) 811, the Circuit Court of Appeals for the 10th Circuit held, in an opinion by Judge Phillips,* that where a newly organized corporation had issued all its capital stock for nine oil leases plus $6,195.36 cash, with no segregation of the number of shares to each of the leases or to the cash, the value of so many of the shares as had been issued for one of the nine leases might be shown by proof of the value of such lease at the time of its acquisition by the company. In the case at bar the Tax Court and the Court below held that the value of so many of the shares of petitioner's stock as were issued for the stock of Pressed Steel Company could not be shown by proof of the then value of the Pressed Steel stock, because at the same time other shares

*This case, together with the prior decisions of the Board of Tax Appeals to the same effect, are fully analyzed in the Brief following, pages 15-30 hereof.

of petitioner's stock had been issued in exchange for other items of property, with no segregation of a given number of shares to the Pressed Steel stock and to the other items of property, factors which were also present in the *McKinney* case.

The Court below, as well as the Tax Court, agreed that where a newly organized corporation issues all its stock for a given piece of property, and there is no other feasible way of proving the value of the stock so issued and hence the tax basis for the property acquired, this may be shown by proof of the fair value of the property so acquired. They held, nevertheless, that this principle does not apply where several items of property were acquired by the issue of all such corporation's stock, with no proof of how many shares were issued for each item, despite numerous decisions by the Tax Court and the decision by the 10th Circuit above cited to the contrary, to none of which the Court below refers in its opinion, although they were cited to the Court in the briefs of counsel for the taxpayer.

In the organization of a business corporation, it is quite usual, particularly when such corporation takes over one or more going enterprises, for one or several blocks of its stock to be issued, in the aggregate, in exchange for several items of property. Where, as in the case at bar, the stock issued to the organizers is not substantially proportionate to the values of the property contributed,[1] the tax basis for determining profit on the subsequent sale by the new corporation of each item of property is the fair value of the shares issued by it in exchange for such property, and not the cost of such property to the transferor (Section 112 (b) (5) being inapplicable). Where, as is frequently the case, there are no contemporaneous sales of the new corporation's stock and no assets of the new cor-

[1] The Court below so held here. See R. 551-2, 143 F. (2d) at page 791.

poration giving its stock value, other than the assets in question newly contributed thereto, the method of determining the value of the new stock is by proof as to the value of the property for which the stock was issued. The authority for this method of determining the value of the stock is not only the very reasonable assumption that each of the parties to a business exchange "is getting his money's worth",[2] but also the impossibility of arriving at any other logical or equitable means of valuing such stock.

The decision of the Court below precludes the taxpayer, in cases of not infrequent occurrence, from the only available method of proof of an essential fact. There is, it is submitted, no basis in logic or in law for relegating such a taxpayer to the basis of its transferor, since Section 112 (b) (5) is inapplicable and therefore, under Section 112 (a), the transferor's basis may not lawfully be applied; nor would the Government permit its application if it happened to be higher than the later actual cost of the property to the transferee taxpayer.

II. This Case Raises a Second Important Question of Federal Law, on Which There Is a Conflict of Decisions Between the Court Below and That of the Fourth Circuit in Another Case.

In *Warren Tel. Co. v. Commissioner*, 128 F. (2d) 503 (cert. den. 317 U. S. 697), the Circuit Court of Appeals for the 4th Circuit held that the provisions of a preferred stock certificate prohibiting the payment of dividends on the common stock while cumulative preferred dividends were in arrears *did not* constitute a "written contract executed by a corporation . . . which . . . expressly deals with the payment of dividends," giving rise to a credit against undistributed profits tax under Section 26 (c) (1) and (2) of the Revenue Act of 1936. In *Lehigh Structural Steel Co.*

[2] See *Commissioner v. Mesta*, 123 F. (2d) 986, 988 (C. C. A. 3d).

v. Commissioner, 127 F. (2d) 67, the Circuit Court for the Third Circuit held that the provisions of a preferred stock certificate *did* constitute such a contract insofar as they required a sinking fund to retire preferred stock and also so held in the case at bar, but further held on reargument in the case at bar, that the provision in the same certificate prohibiting dividends on common stock while preferred dividends were in arrears *did not* constitute such a contract.

The important principle of Federal Tax Law which requires authoritative elucidation by this Court, is the distinction between an agreement made prior to May 1, 1936, by common stockholders with preferred stockholders (as an obvious inducement to the latter to contribute capital to the Company) precluding the payment of common dividends while preferred dividends are in arrears, and an agreement among the common stockholders not to pay dividends to themselves until a given sum is accumulated, the latter being precisely what the Undistributed Profits Tax was intended to discourage.

Although the decision of the Court below, here sought to be reviewed, is not a final disposition by that Court of the case, in that the Court remands the case to the Tax Court for a finding as to whether there was a contract, oral or written, sufficient to satisfy the Amendment of 1942 to Section 26 of the Revenue Act, nevertheless, the decision is final in the Court below as to the two points of law above discussed. Should your petitioner now go back to the Tax Court and that Court resolve the question submitted in petitioner's favor, petitioner would appear to be precluded from contesting by petition for certiorari the soundness of the decision by the Court below on at least these two points. Under the broad provisions of Section 240a of the Judicial Code, particularly as amended by the Act of February 13, 1925 (c. 229, sec. 1, 43 Stat. 938) by inserting the phrase "either before or after a judgment or

decree by such lower court," this Court may, in a proper case, review by certiorari cases which have not yet been finally disposed of below.

III. This Case Involves a Further Important Question of Federal Tax Law, on Which the Decisions of the Lower Courts Are Confused, and on Which There Is No Clear Pronouncement by This Court.

The Court below did not discuss in its opinion the question decided against your petitioner by the Tax Court, and discussed in the briefs for both sides in the Court below, as to whether the redemption by petitioner of its preferred stock amounted, as to the $12.25 per share accumulated dividends in arrears, to the payment of a taxable dividend. Petitioner contended that it did and that it was consequently entitled to a credit in reckoning undistributed profits tax, of $12.25 per share on the 68,572 shares redeemed from Schroder & Company, as well as on the 8,000 shares of the Manufacturing Company on which the dividend was paid as such immediately prior to their redemption.

BUDD INTERNATIONAL CORPORATION,

By EDWARD G. BUDD, *President,*
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BRIEF IN SUPPORT OF THE PETITION.

The Evidence Offered Was Legally Sufficient to Require a Finding as to the 1930 Cost to Petitioner of the Pressed Steel Shares.

The purpose of the present brief is to summarize the decisions by the Tax Court and by the Circuit Courts of Appeals, in conflict with the decision of the Court below, on the principal question sought to be reviewed by the present petition,—the adequacy of petitioner's proof, for the purpose of Federal Income and Undistributed Profits Tax, of the value in 1930 of petitioner's shares issued for the Pressed Steel common stock, and hence the amount of gain realized by petitioner through the sale thereof in 1936.

The question being as to the cost of the Pressed Steel shares to petitioner in 1930 (and not its transferor's cost), if such shares had been acquired by the petitioner for cash the amount of such cash would, of course, have been the cost. Similarly, if the shares had been acquired in exchange for a segregated amount of petitioner's stock, which had at the time a clearly ascertainable market value (measured by contemporaneous sales of similar stock in the open market) the cost of the Pressed Steel shares would be taken to be the aggregate fair market value of the stock the petitioner issued in exchange for them. In such a case, where petitioner's shares had a demonstrable market value, this would be conclusive, irrespective of any testimony as to the fair value of the Pressed Steel shares acquired. Such was the decision of the Court below in *Hazeltine Corporation v. Commissioner,* 89 F. (2d) 513.

However, when the asset in question is acquired by the issuance of petitioner's stock, and the fair market value of the latter cannot be ascertained from sales in the open mar-

ket, the Commissioner, the Tax Court and the Federal Courts have repeatedly and consistently held that the fair value of the stock issued in exchange for the asset (which represents the cost of the asset) may be measured by the fair value of the asset acquired, whatever the number of the shares of such stock.

On page 28 of their principal brief in the Court below, in the course of their argument on another point, the respondents said:

> "The courts have consistently held that in the absence of other evidence, the value of the stock shall be deemed to be the value of assets received in exchange therefor. Where all the capital stock of a newly formed corporation is issued for the property and there is no other method of measuring the fair market value of the stock so issued, however, such fair market value on that date may properly be determined to be the equivalent of the fair market value of the property received. *Commissioner v. W. S. Farish & Co.*, 104 F. 2d 833 (C. C. A. 5th); *Commissioner v. McKinney*, 87 F. 2d 811 (C. C. A. 10th). . . ."

The above rule is not, as the Tax Court and as the Court below in their decisions in the instant case apparently supposed, confined to cases where the entire stock of the newly organized corporation is issued for a single asset. Contrary to the ruling of the Tax Court and of the Court below in the case at bar, it has been applied equally by the Tax Court and by the Federal Courts to cases in which the particular asset under investigation has been acquired along with other assets in exchange for a block of stock having no recognized market value, and where there has been no segregation of the numbers of shares issued in exchange for each of the assets acquired. For that matter, if a taxpayer should undertake arbitrarily to apportion the shares issued among the several assets acquired, this would not be conclusive.

The principle is analogous to the Best Evidence Rule. The cost of the asset being the value of the block of stock issued in exchange for it, if such stock has a recognized market value, evinced by open sales, this is conclusive, irrespective of any testimony as to the fair value of the assets acquired in exchange for the stock. Where, however, the stock has no such recognized market value, unless such value may be taken as equivalent to the value of the property received, the taxpayer would, in such cases, be absolutely precluded from showing the cost basis *which the Court holds to be the proper basis for computing his tax.* In the case at bar, the Court below has expressly held that such basis is the cost to petitioner in 1930 and not the cost to petitioner's transferor in 1926. If the cost to petitioner's transferor in 1926 had been $10,000,000 instead of $1,000,000, would petitioner be permitted to use the $10,000,000 figure and claim a $4,000,000 loss on the sale of this asset for $6,000,000 in 1936, which was admittedly worth but $3,500,000 when acquired by petitioner in 1930, merely because no one could determine exactly how many of petitioner's shares were exchanged for it?

It is difficult to understand why either the Tax Court or the Court below considered that it would be instructive or helpful in solving this problem to ascertain what was the fair value of the assets acquired for the 360,000 shares *in addition* to the Pressed Steel stock, since the mere fact that one or more items in addition to that in question were received in exchange for a block of stock cannot affect the application of the principle. The Court below, in making its ruling, assumes that the fair market value of the Pressed Steel shares exchanged with other assets for the 360,000 shares of petitioner's common stock, was $3,500,000, but adds, in effect, that where any other substantial asset formed part of the consideration for the 360,000 shares, the value of the Pressed Steel shares could in no case be taken as the value of *whatever portion* of the stock was issued for them.

The proposition that the cost of one of several assets acquired for stock cannot be measured by the then fair market value of that asset leads inescapably to a completely unworkable result. In order to simplify the question, let us assume that the block of 360,000 shares was issued only for the Pressed Steel shares and those of Ambi-Budd; that the fair market value of the Pressed Steel shares was $3,500,000, and that of Ambi-Budd $1,000,000. The total stock acquired would admittedly be worth $4,500,000, and under the cases cited by the Tax Court, the value of petitioner's shares issued in exchange for the two items, and hence their cost, would be $4,500,000. It is, however, no greater assumption to assume that the value of *whatever part* of petitioner's stock was issued for each of the items should be measured by the fair value of *such item*.

Under the decisions it is a proper assumption that the fair value of *all* the shares issued is equal to that of *all* the assets received. It is no more unreasonable to assume that the value of whatever *part* of the shares was issued for a given asset is equal to the value of that asset, irrespective of what other assets were at the same time acquired by the issue of other shares, and irrespective of the number of shares issued in exchange for the asset in question. Indeed, where several assets were acquired for a large block of stock, it is immaterial for the purpose of the present question how many shares were issued in exchange for the respective assets, since it is not the unit value of the shares which we are considering, but the cost of the asset acquired, which is the *total value* of the shares issued in exchange for it, *whatever be the number of shares or whatever be the value of each share*. There can be no doubt that the Pressed Steel shares were acquired in exchange for some part of the 360,000 shares, but neither the actual number nor the unit value of that part is important —merely the aggregate value of *all* the shares issued for the Pressed Steel shares, *whatever their number and value be*.

Prior Decisions by the Tax Court Contrary to That in the Case at Bar.

The Court below and the Tax Court were entirely in error in supposing that the principle of using the fair value of the asset acquired as a measure of its cost has been confined to cases of the issue of the stock of a newly formed corporation in exchange for a *single asset*. The test of the application of the principle is not whether one asset or more was acquired at the same time, but whether the stock issued in exchange had a recognized market value without reference to the value of the asset acquired. The decisions of the Board of Tax Appeals prior to that in the present case are uniform to this effect. The first case announcing this principle is *Appeal of William Ziegler*, 1 B. T. A. 186, 192, where the Board thus stated it:

> ". . . The usual method of appraising stock issued for property *where there is no evidence of the market value* of the stock is to say that the stock is deemed equivalent in value to the property for which it was issued, and by determining the value of the property one can determine the value of the stock." (Italics supplied.)

This case was cited with approval and followed by the Board in *Appeals of Plunkett, et al.*, 3 B. T. A. 1265, and *Rouse, Hempstone & Co., Inc.*, 7 B. T. A. 1018. In the latter case the Board stated the principle as follows:

> "We are convinced from the evidence that the petitioner's merchandise inventory at December 1, 1917 had a market value of at least $286,349.72. As the inventory, among other assets, was purchased for stock, that amount then becomes the cost of the merchandise to the petitioner, for, where goods are purchased for stock, in the absence of evidence of the market value of the stock, it is deemed equivalent in

value of the property for which it was issued." (p. 1024)

In the case last cited the Board used the respective inventory values of the numerous items of merchandise as the basis for determining profit on the sale of such items, irrespective of the fact that the whole inventory was acquired by the issue of a block of stock, with no possible allocation of any specific number of shares to the respective items.

Under the Commissioner's regulations, where it is necessary to fix the cost of certain items of property acquired, for a lump sum, with other items, this is done proportionately to the value of the several items. Article 23 (l) 4 of the Regulations provides:

> "In the case of the acquisition on or after March 1, 1913, of a combination of depreciable and non-depreciable property for a lump price, as, for example, buildings and land, the capital sum to be replaced is limited to an amount which bears the same proportion to the lump price as the value of the depreciable property at the time of acquisition bears to the value of the entire property at that time."

In accordance with the foregoing principle, where two items are acquired, one having a value of $1,000,000 and the other a value of $3,500,000, the method for determining the cost of the item worth $3,500,000 is to allocate the shares by reference to the items' respective values, that is, to determine that $\frac{3,500,000}{4,500,000}$ times the total shares were issued for that item. It would follow that $\frac{3,500,000}{4,500,000}$ times $4,500,000, or $3,500,000, was the cost of the item. Now suppose another case, where two items were so transferred,

and one was worth $3,500,000 but the other was worth $5,000,000. Applying the same principles, the total value of the stock would be $8,500,000 and of this $\frac{3,500,000}{8,500,000}$ would be allocated to the asset worth $3,500,000. The cost of that asset would then be $\frac{3,500,000}{8,500,000}$ times $8,500,000, or $3,500,000.

The value of the *other* asset, the cost of which is not being determined, has absolutely no effect on the result. We submit that the ends of justice cannot be served by a rule requiring a taxpayer, at his peril, to prove a fact which has *no bearing whatever* on the point in issue.

In *John Glackner Realty Corp. v. Commissioner,* 11 B. T. A. 151, the question was as to the amount of profit made by petitioner during the calendar year 1921 from the sale of two properties. The petitioner was organized in January, 1919, and immediately thereafter issued all its capital stock, consisting of 4500 shares, to John Glackner, the president, "in exchange for *four* properties situated in the Borough of Manhattan, New York City," no particular number of shares being allocated to any one property.

In 1921 petitioner sold *two* of the properties, the first for $13,536 and the second for $61,062.50. Expert witnesses, having knowledge of the properties and of their market value, testified as to what was the market value of the two properties respectively on January 17, 1919, when the corporation acquired them. "The respondent has offered no evidence to contradict the testimony of these witnesses, and we see no reason why their opinions are not to be relied on."

They testified that the value of the first property was $12,500 and that of the second $59,000. Although there was apparently no testimony as to the values of the other two properties, the Board held that the respective values

of the two properties sold, less proper depreciation, fixed the basis for the profit realized by their sale. Commissioner Murdock said (p. 152):

> "since the petitioner issued all of its capital stock for these two properties and two others, as a whole, the cost thereof to the petitioner was the market value of the properties at the date of acquisition. Rouse, Hempstone & Co., Inc., 7 B. T. A. 1018, 1024; and see Terrace Drive Co., 5 B. T. A. 1161."

The Board found no difficulty incident to the fact that the value of the other two properties was not shown, or to the circumstance that there was no segregation of the shares issued for the two properties in question. The question was precisely that here involved.

The *Ziegler* case was also quoted with approval by the Board in *Schoenheit's Appeal*, 14 B. T. A. 33 (reversed on other grounds in 44 F. (2d) 476), and the principle was followed by the Board in *Melrose Trust Co.*, 22 B. T. A. 538.

In *Reliance Investment Co. v. Commissioner*, 22 B. T. A. 1287, decided by Board Member Sternhagen, it appeared that in 1925-1926-1927, petitioner sold certain bonds of the Rock Island Railroad *which, with bonds of other companies*, it had acquired in 1914 in exchange for all its stock. The Bloch Brothers Tobacco Company having, on February 5, 1914, delivered to the petitioner bonds having a total face value of $1,212,051 in exchange for 19,985 shares of petitioner's stock, the remaining 15 shares being issued 3 to each of 5 individuals, on payment of $5 a share.

The Commissioner contended that the cost to petitioner was measured by the fair value of the bonds on the date of their acquisition, February 5, 1914, while the petitioner contended that the basis was the higher cost paid by its predecessor before March 1, 1913. The Board adopted the Commissioner's contention. Member Sternhagen said (pp. 1289-1290):

"The petitioner in 1925, 1926 and 1927, sold property which it had in 1914 acquired in exchange for all its stock. The respondent computed the gain from these sales upon the basis of the cost to petitioner in 1914. The cost was taken to be the value of petitioner's stock when issued for the property, and such value was taken as the equivalent of the stipulated value of the property received. *This is the long accepted way of determining such cost.* William Ziegler, Jr., 1 B. T. A. 186; Mead Realty Co., 21 B. T. A. 1062." (Italics supplied.)

This decision, flatly contrary to that by the same Member in the case at bar, is not referred to by him in his present opinion.

In *Gillette Rubber Company v. Commissioner,* 31 B. T. A. 483, 490, Board Member Goodrich said:

"The parties agree, and upon examination we accept their conclusion, that petitioner's acquisition of the assets of the old company and the distribution of its securities did not constitute a statutory reorganization. Consequently, the cost basis of the assets in the hands of the old company does not carry over and it becomes necessary to determine the basis of the assets in the hands of petitioner. It is clear that the fair market value of the securities issued in payment for the assets is the cost basis for the assets in petitioner's hands. Sec. 204 (a), (c), Revenue Act, 1926; sec. 111 (a), sec. 113, sec. 114, sec. 23, Revenue Act, 1928, as to basis for determining gain or loss and allowances for depreciation. Likewise, it appears that if the fair market value of the securities so issued cannot be determined from the record of sales thereof, or other evidence pertaining to the securities, then the value to be assigned to them, and to be taken as the cost basis of the assets in petitioner's hands, is the fair

market value of the assets for which they were exchanged. For statements and discussion of this rule see: *William Ziegler, Jr.*, 1 B. T. A. 186; *Wallis Tractor Co.*, 3 B. T. A. 981; *George A. Ricker*, 10 B. T. A. 11; *John Glackner Realty Corporation*, 11 B. T. A. 151; *Kanawha City Co.*, 13 B. T. A. 912; *Jefferson Livingston*, 18 B. T. A. 1184; *Reliance Investment Co.*, 22 B. T. A. 1287; *Biscayne Bay Islands Co.*, 23 B. T. A. 731; *Stollwerck Chocolate Co.*, 4 B. T. A. 467, 470."

In *Himmelhoch Brothers & Co.*, 26 B. T. A. 541, 547, the Board said:

"Where, as here, property is exchanged for stock, and there is no evidence as to the value of the stock, the value of the property when acquired establishes the cost of the asset to the transferee. *Rouse, Hempstone & Co.*, 7 B. T. A. 1018; *John Glackner Realty Corporation*, 11 B. T. A. 151; *Whiting Lumber Co.*, 21 B. T. A. 721; *Mead Realty Co.*, 21 B. T. A. 1062; *Melrose Trust Co.*, 22 B. T. A. 538."

See also *Lyon, Inc.*, 42 B. T. A. 1094, 1101 (footnote).

Conflicting Decision by the Tenth Circuit.

The case of *Commissioner v. McKinney*, 87 F. (2d) 811, decided by the 10th Circuit in January, 1936, is directly in conflict with the decision of the Court below in the case at bar.

There the question was as to the tax liability of the individual respondent for 1927. On November 13, 1922, respondent inherited nine oil and gas leases which, plus cash in the sum of $6,195.36, on May 23, 1924, she transferred to Johneda Oil Company in exchange *for all its capital stock.*

At the time she acquired the nine leases, their fair values were as follows:

Okesa	$ 712.21
Preston	3,414.60
Shepherd	930.59
Osage Foster	4,560.72
Collier	276.04
Buchanan	2,759.68
Elgin	11,714.28
Section 5, Osage Co.	4,426.49
Sections 22 and 23, Osage Co.	28,776.38
Total	$57,570.99

During the period between November 13, 1922, and May 23, 1924, oil was discovered on the lease on sections 22 and 23 in Osage County, and the fair market value of that lease on the date of the transfer was $247,500, that of the other leases being the same as on their acquisition. The estimated recoverable oil content of sections 22 and 23 was 300,344 barrels.

In 1927 respondent received a distribution from the corporation of $165,519.20. The question was as to what part of the distribution was from depletion reserve and what part was a dividend. The Commissioner computed the depletion from sections 22 and 23 on the basis of transferor's cost $28,776.38, or at about 9½¢ per barrel, holding that $140,449.35 of the $165,519.20 constituted dividends and but $25,069.85 a return of capital. If, however, the depletion were computed on the basis of the cost to the corporation measured by the value of the lease at the date of transfer ($247,500)the depletion per barrel would be at the rate of about 82½¢ per barrel and a much less part of the distribution constituted dividends. The Board of Tax Appeals (32 B. T. A. 450, 456), in an opinion by Member Turner, held that the amortization was to be based on the cost of the respective leases to the corporation *at the time of the transfer.*

There was, of course, no testimony obtainable as to the unit value at this time of the stock of the Company, other than the fact that all such stock had been issued in exchange for the nine leases plus the $6,195.36 cash. Accordingly, the use of the figure $247,500 as the cost of the lease on sections 22 and 23 necessarily involved the conclusion that, in such a case, the fair value of the stock issued for such lease (whatever its amount in shares) was the then fair value of such lease. The Board so held and said (p. 456):

> "It is well settled that the cost to a corporation of the property acquired through the issuance of its capital stock is the fair market value of such capital stock on the date issued, and where all of the capital stock of a corporation is issued for property and there is no other method of measuring the fair market value of the stock so issued, such fair market value on that date may properly be determined to be the equivalent of the fair market value of the property received. Reliance Investment Co., 22 B. T. A. 1287; Mead Realty Co., 21 B. T. A. 1062; L. H. Philo Corporation, 16 B. T. A. 130; John Glackner Realty Corporation, 11 B. T. A. 151; Realty Sales Co., 10 B. T. A. 1217.
>
> "It has been stipulated that the fair market value of the lease on sections 22 and 23, Osage County, the property forming the basis for the controversy herein, was $247,500 on the date acquired by the Johneda Oil Co. for its stock, and, under the decisions cited, this value was the cost of the property to the corporation."

The Circuit Court of Appeals for the Tenth Circuit affirmed the judgment of the Board of Tax Appeals, holding, in an opinion by Judge Phillips, that for the purpose of determining what part of the distribution was dividends, the cost of the leases to the corporation was the fair market value at their date of acquisition by the corporation and not the cost to the transferor, this, despite the fact that in

reckoning the profit of respondent in the sale of the stock, the basis would be the cost to the transferor. Accordingly, the Court sustained the position of the taxpayer, making it necessary to determine the cost to the corporation of the respective leases at the date of their acquisition by it.

Having determined that the basis was the cost to the corporation, the Court held that this cost was measured by the value of the respective leases at the time of their acquisition by the corporation, using $247,500 as the cost of the lease in sections 22 and 23, although, as in the case at bar, this asset was acquired by the corporation *together with other assets* in exchange for all the corporation's stock. It was there possible to segregate $247,500 as the cost of the lease on sections 22 and 23, only by assuming that the fair value of the amount of stock issued in exchange *for such lease, whatever the number of shares or their unit value,* was equal to the fair value of the asset received for such stock. Apparently the Court found no such difficulties as the Court below did in its original opinion. The case involves precisely the question here presented. Judge Phillips said, in the course of the opinion (p. 816):

> "The cost of the leases to the corporation was the value of the stock less the cash paid in by respondent. The value of the stock is measured by the value of the leases received in exchange for the stock at the time of the transfer, or $276,304.61 plus the cash paid in by respondent."

In this case, as in the case at bar, it was impossible to determine what part of the stock on which respondent received his dividends had been issued for the $6,195.36 cash and what part for each of the nine leases, yet the court had no hesitation in arriving at the cost of *such part* of the stock as was issued for the lease on sections 22 and 23, as the then market value of that lease, *without determining how many shares had been issued for such lease.*

Other Federal decisions point to the same conclusion.

In *Hunt v. Commissioner,* 82 F. (2d) 668, certain items of the machinery which had been purchased with taxpayer's stock, were not delivered because of the insolvency of the owner and taxpayer claimed a deduction by reason thereof, but proved neither the fair value of the stock at the time the contract was made, nor the value of the machinery. The court held that he had not made out his case, but said (pp. 670, 671):

> "In the absence of proof as to what that machinery was worth, petitioner is without any basis to compute his loss for failure to deliver any part of it. He cannot do this by proving what the balance of the treasury stock sold for at a later period, or what the stock was worth when considerable sums of money had been paid in on the plant. The basis for the determination of his loss is the value of the stock when it was contracted to be given in exchange for the machinery. *If he had proven this by proving the value of the machinery at that time, he would have established his cost basis.* If he had proven that the half of the machinery which was not delivered continued to be of the same value, and that it was worth more than the $22,500 cash paid in lieu of delivery, to the extent of the difference he would have established his loss. . . . (Emphasis supplied.)
>
> "In this state of the record, with no proof of what the stock was worth at the time the contract was made to measure the value of the machinery by, nor of the value of the machinery to measure the value of the stock by, there is no basis in the record for a deduction allowance on this score; indeed, the reasonable deduction from all the evidence is that there was no loss."

That the cost of shares is the value of assets transferred in exchange for them, see also *Volker v. U. S.,* 40 F. (2d) 697, W. D. Mo.

It is respectfully submitted that this case involves several important questions of Federal law on which the decisions of the lower Courts are in conflict and which should be settled by this Court.

Respectfully submitted,

HENRY S. DRINKER
FREDERICK E. S. MORRISON
JOHN W. BODINE
For Petitioner.

APPENDIX.

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

* * * * * *

(5) *Transfer to corporation controlled by transferor.*—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

* * * * * *

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 26. CREDITS OF CORPORATIONS.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

* * * * * *

(c) *Contracts restricting payment of dividends.*—

(1) *Prohibition on payment of dividends.*—An amount equal to the excess of the adjusted net income over the aggregate of the amounts which can be dis-

tributed within the taxable year as dividends without violating a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the payment of dividends. If a corporation would be entitled to a credit under this paragraph because of a contract provision and also to one or more credits because of other contract provisions, only the largest of such credits shall be allowed, and for such purpose if two or more credits are equal in amount only one shall be taken into account.

(2) *Disposition of profits of taxable year.*—An amount equal to the portion of the earnings and profits of the taxable year which is required (by a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the disposition of earnings and profits of the taxable year) to be paid within the taxable year in discharge of a debt, or to be irrevocably set aside within the taxable year for the discharge of a debt; to the extent that such amount has been so paid or set aside. For the purposes of this paragraph, a requirement to pay or set aside an amount equal to a percentage of earnings and profits shall be considered a requirement to pay or set aside such percentage of earnings and profits. As used in this paragraph, the word "debt" does not include a debt incurred after April 30, 1936.

* * * * * *

SEC. 27. CORPORATION CREDIT FOR DIVIDENDS PAID.

* * * * * *

(f) *Distributions in liquidation.*—In the case of amounts distributed in liquidation the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, shall, for the purposes of computing the dividends paid

credit under this section, be treated as a taxable dividend paid.

* * * * * *

(g) *Preferential dividends.*—No dividends paid credit shall be allowed with respect to any distribution unless the distribution is pro rata, equal in amount, and with no preference to any share of stock as compared with other shares of the same class.

* * * * * *

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of gain or loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(c) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

* * * * * *

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

* * * * * *

(5) *Transfer to corporation controlled by transferor.*—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

(c) *Gain from exchanges not solely in kind.*—

(1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5) of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

* * * * * *

(h) *Definition of control.*—As used in this section the term "control" means the ownership of stock possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

* * * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that—

* * * * * *

(8) *Property acquired by issuance of stock or as paid-in surplus.*—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112 (b) (5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), * * *

then the basis shall be the same as it would be in the hands of the transferor, * * *

Revenue Act of 1942, c. 619, 56 Stat. 798:

SEC. 501. ADDITIONAL CREDITS FOR UNDISTRIBUTED PROFITS TAX.

(a) *Amendments to the Revenue Act of 1936*—

* * * * * *

(3) Section 26 of the Revenue Act of 1936 (relating to credits of corporations) is amended by adding at the end thereof the following new subsections:

* * * * * *

"(g) *Stock redemption credit.*—An amount equal to the portion of the recognized gain, realized within the taxable year and prior to March 3, 1936, from the sale or other disposition of a capital asset, which, pursuant to a contract, was distributed prior to such date to shareholders in redemption in whole or in part of preferred stock and which is not otherwise allowable as a credit under any other provision of this section or section 27."

(b) *Effective date of amendments.*—The amendments made by subsection (a) shall be effective as of the date of the enactment of the Revenue Act of 1936.

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In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 764

BUDD INTERNATIONAL CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 495–522) is reported in 45 B. T. A. 737. The original opinion of the Circuit Court of Appeals (R. 540–554) is reported in 143 F. 2d 784, and its opinion on rehearing (R. 563–568) is reported in 143 F. 2d 792.

JURISDICTION

The judgment of the Circuit Court of Appeals after rehearing was entered on July 17, 1944 (R. 569). By order of this Court entered on October 11, 1944, the time for filing a petition for certiorari was extended to and including Decem-

ber 16, 1944 (R. 571). The petition for a writ of certiorari was filed on December 16, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the taxpayer's evidence compelled the Tax Court to find that the cost of property acquired by the taxpayer in exchange for a part of its stock in 1930 was $3,000,000, or any other sum in excess of the cost originally used by the taxpayer in its returns and accepted by the Commissioner.

2. Whether the provisions of the taxpayer's articles of incorporation and its preferred stock certificates, to the effect that cumulative dividends must be paid upon preferred stock before dividends could be paid upon common, constitute a written contract which prohibited the payment of dividends within the meaning of Section 26 (c) (1) of the Revenue Act of 1936.

3. Whether the petition presents any other important question regarding the taxpayer's undistributed profits tax, the Circuit Court of Appeals having remanded the case to the Tax Court for findings necessary to a determination of the applicability of the relief provision in Section 26 (g), added to the Revenue Act of 1936 by Section 501 (a) (3) of the Revenue Act of 1942.

STATUTES INVOLVED

The pertinent statutes are set forth in the Appendix, *infra,* pp. 17–19.

STATEMENT

The pertinent facts found by the Board of Tax Appeals (R. 497–507) may be summarized as follows:

The taxpayer, Budd International Corporation, was organized on August 7, 1930, pursuant to the terms of an agreement dated April 24, 1930, between the Edward G. Budd Manufacturing Company (hereinafter called Manufacturing Company), J. Henry Schroder & Company, a London banking house (hereinafter called Schroder), and the J. Henry Schroder Banking Corporation, of New York (R. 497).

During 1926 the Manufacturing Company acquired 64% of the common shares of the Pressed Steel Company of Great Britain, Limited (hereinafter called Pressed Steel), consisting of 20,900 Class A and 17,500 Class B, at a cost of $1,000,000, and it also, by subscription, acquired 1,000 preference shares of Pressed Steel. It paid $344,458.01 of the subscription price, leaving 30% unpaid. The rest of Pressed Steel's shares were acquired by Schroder. (R. 498.) The Manufacturing Company also owned shares of Ambi-Budd Presswerk (hereinafter called Ambi-Budd) (R. 497), a German corporation (R. 498.)

On September 19, 1930, as contemplated by the agreement of April 24, 1930, the taxpayer made agreements with the Manufacturing Company, pursuant to which the Manufacturing Company transferred to the taxpayer the following property: (1) 38,400 common and 1,000 preference shares of Pressed Steel; (2) 50.59% of the outstanding common shares of Ambi-Budd; (3) royalties and other benefits to become due under license contracts between the Manufacturing Company and the Citroen automobile concern, Ambi-Budd and Pressed Steel, which the Manufacturing Company agreed not to modify or terminate; (4) all assets of the Manufacturing Company in Europe, comprising all of its European patent rights. The Manufacturing Company further promised to assign to the taxpayer licenses for the use of future patents and processes; to give advice and information on operation; to furnish the taxpayer with funds to pay the dividends on preferred shares in case its earnings should be insufficient, and to guarantee that payment; and to subscribe and pay for 3,428 more preferred and 3,428 more common shares if the taxpayer should be required to pay the additional unpaid subscription price of the Pressed Steel preference shares. (R. 498–499.)

The taxpayer issued 360,000 common shares to the Manufacturing Company and promised to pay it $344,458.01 (the amount which had been paid by the Manufacturing Company on the price of the

1,000 Pressed Steel preference shares), and to assume the obligation for the unpaid balance on the Pressed Steel preference shares (R. 499).

Simultaneously and pursuant to the agreements, the Manufacturing Company subscribed for 76,572 preferred and 76,572 common shares of the taxpayer's stock for $3,350,025. Schroder, having previously agreed to take over 68,572 shares of each class, paid $3,000,025 to the Manufacturing Company which immediately paid this amount, together with $350,000, to the taxpayer. Thereupon the taxpayer paid the Manufacturing Company $350,000 cash in accordance with its promise (the promise was to pay $344,458.01). The taxpayer then issued 76,572 preferred and 76,572 common shares to the Manufacturing Company, which simultaneously transferred 68,572 of each to Schroder. After the consummation of these transactions the Manufacturing Company held 8,000, or 10.45%, of the taxpayer's preferred shares and 368,000, or 84.29% of its common shares; Schroder held the remainder, *viz*, 68,572 preferred and 68,572 common shares. (R. 499.)

In 1935 the taxpayer approached Schroder in London on the subject of a disposition of the taxpayer's Pressed Steel shares in some manner which would yield cash. During the course of negotiations, Schroder insisted on the retirement of its shares of the taxpayer's preferred as a con-

dition of any trade with it. Schroder interested the British Pacific Trust, Limited, in a purchase of Pressed Steel common shares. On December 12, 1935, the taxpayer secured from British Pacific Trust, Limited, an option or "put" giving the taxpayer the right to demand that British Pacific buy its 332,595 Pressed Steel common shares. (R. 503.) During January 1936, the taxpayer exercised the "put" and sold the Pressed Steel common. It also authorized its officers to sell 81,667 Pressed Steel preferred to Schroder. About February 15, 1936, the transactions were consummated at Schroder's London office. The taxpayer transferred 332,595 Pressed Steel common "to Schroder and British Pacific Trust, Limited" and 81,667 Pressed Steel preferred to Schroder. British Pacific paid to Schroder and Schroder credited the taxpayer's account with $5,601,315.54 for the Pressed Steel common. Schroder also credited the taxpayer's account with $503,303.95 for the Pressed Steel preferred. The total credit left was $6,105,619.47, and a charge for expenses left a credit of $5,830,990.34 as net proceeds from the sale. (R. 504.)

Schroder and the Schroder Banking Corporation, New York, then sent to the taxpayer certificates for 68,572 shares of its preferred, and these were cancelled. The taxpayer redeemed them at the rate of $57 a share. Redemption payment was made by a charge of $3,908,604 against the taxpayer's account with Schroder. (R. 504.)

On February 17, 1936, the taxpayer's board of directors declared a dividend of $12.25 a share on the 8,000 preferred shares still outstanding and $1.50 a share on the outstanding 436,572 common shares. On March 5, 1936, the taxpayer made a further distribution of $44.75 a share in redemption of the 8,000 preferred shares which it thus acquired and cancelled. The $3.50 annual cumulative dividends on 76,572 preferred shares were in arrears from June 30, 1932, and amounted on December 31, 1935, to $12.25 a share. (R. 504–505.)

By the taxpayer's amended certificate of incorporation (R. 193–211), holders of preferred shares were entitled to receive out of surplus or net profits "cumulative dividends at the rate of $3.50 per annum and no more * * * before any dividend shall be paid or set apart upon the common stock" (R. 196). Preferred shares were subject to redemption on notice at $52 a share plus accrued dividends, and a sinking fund was required for that purpose in which the taxpayer should place each year an amount equal to 3% of the largest number of preferred shares which had ever been outstanding (R. 197–199). Holders of preferred shares were not entitled to vote at shareholder's meetings unless preferred dividends in the amount of $3.50 a share should be in arrears; if the arrearage should be $7 a share, they were empowered to demand resignation of

officers, directors and executive committeemen, sufficient in number to permit them to elect majorities (R. 200). While preferred shares were outstanding, the taxpayer was forbidden to reduce its earned surplus by any disposition to common stockholders below the lesser of (a) $120,000 and (b) net profits for 1930 and 1931, remaining after payment of preferred dividends (R. 197). These and other charter provisions relating to preferred shares were printed on the back of the share certificates (R. 323) and remained in force until the preferred shares were retired and cancelled in 1936 (R. 501–502).

Prior to 1936 the taxpayer paid no dividend on its common shares. It never created the sinking fund required for redemption of the preferred shares. Preferred dividends of $469,003.50 were paid for the period October 1, 1930, to June 30, 1932. Preferred dividends remained unpaid thereafter, and to the end of 1935 were in arrears in the amount of $12.25 a share. (R. 503.)

The Commissioner determined deficiencies of $631,006.24 and $25,296.31 in petitioner's income taxes for 1936 and 1937, respectively (R. 18). As will appear from the Argument, the Commissioner was upheld in part by the Board and the court below (R. 531, 543, 545–546, 553).

ARGUMENT

1. The taxpayer's gain on its disposition of the Pressed Steel shares in 1936, the Circuit Court

of Appeals held (R. 548–552), is to be computed by taking as a basis the cost of those shares to the taxpayer upon its organization in 1930.[1] In so holding, the Circuit Court of Appeals rejected the contention of the Commissioner that the transfer of the Pressed Steel shares to the taxpayer in 1930 was a tax-free exchange under Section 112 (b) (5) of the Revenue Act of 1936 (Appendix, *infra*, p. 18) by virtue of which the taxpayer's cost basis should be related back under Section 113 (a) (8) (A) (Appendix, *infra*, pp. 18–19) to the cost of the shares to the Manufacturing Company, the taxpayer's transferor.

By way of proving the cost of the Pressed Steel shares to the taxpayer in 1930, the taxpayer introduced evidence of the fair market value of the Pressed Steel shares in 1930. However, as the Board and the Circuit Court of Appeals observed (R. 509–510, 522), the cost to the taxpayer of the Pressed Steel shares was not their fair market value, but the fair market value of the stock of the taxpayer which the taxpayer issued in exchange for them.

The stock of the taxpayer had not been the subject of any sale, and accordingly its fair market value could not be established by resort to market price. Nor could the value of the stock

[1] The Board of Tax Appeals reached the same conclusion in its opinion (R. 508–509) but stated its conclusion as *obiter dictum*.

be measured by the value of the assets behind it; the stock was issued in exchange for a variety of assets transferred to the taxpayer by the Manufacturing Company and Schroder (R. 498–499), but the total value of these assets was not known; a large part of the assets had no value ascertainable from the record. Moreover, even if the total value of the taxpayer's common stock were known, it would still be impossible to say what value the taxpayer paid for the Pressed Steel shares; the record affords no means of knowing what part of the taxpayer's common shares was issued in exchange for the Pressed Steel shares. For these reasons the courts below both held that the taxpayer had failed to prove that its cost of the Pressed Steel shares was in excess of $1,000,000, the figure originally used by the taxpayer and accepted by the Commissioner (R. 509–511, 552–553, 565–568).

The taxpayer does not claim that there is any proof to supply the vacancies in the record held fatal by the courts below. Rather, the taxpayer asserts here (Pet. 17–18) that it is not necessary to know how many or what unit value of the taxpayer's shares were issued respectively in exchange for the Pressed Steel shares and other assets. It asserts (*ibid.*) that one may simply ascribe to the taxpayer's shares, whatever their number and value, the value of the Pressed Steel shares for which an

unknown number and value of the taxpayer's common were issued.

This reasoning pays slight service, if any, to the premise accepted by the taxpayer (Pet. 15), namely, that the question here is the cost to the taxpayer of the Pressed Steel shares. The argument necessarily assumes the conclusion—that the cost was the same, dollar for dollar, as the value of the shares received (Pet. 12, 18).

Such an assumption is hardly borne out by common experience. Here it runs directly contrary to the taxpayer's assertions successfully made below. The Circuit Court of Appeals accepted the taxpayer's contention that Section 112 (b) (5) was inapplicable to the 1930 exchange because, when the Manufacturing Company and Schroder transferred to the taxpayer the properties which came to constitute all of the taxpayer's assets, the shares issued by the taxpayer to the Manufacturing Company and Schroder were not substantially in proportion to the interest of the Manufacturing Company and Schroder in the properties prior to the exchange. Accepting the taxpayer's valuations in that respect, the Circuit Court of Appeals held that the Manufacturing Company contributed 61% of the property and received 46% of the stock, and Schroder contributed 39% of the property and received 54% of the stock (R. 551). In short, the taxpayer's

stock was not issued, dollar for dollar, for value received, and the assumption essential to the taxpayer's argument (Pet. 12, 18) is untenable.

The decision below is not in conflict with *Commissioner* v. *McKinney,* 87 F. 2d 811 (C. C. A. 10th (Pet. 24–25). There all of the newly formed corporation's stock was issued in exchange for nine oil and gas leases, each of known value, and a sum certain in cash, and the stock could readily be taken as having the same value as the assets behind it. Moreover, the properties transferred to the corporation were all transferred by one person, and the element of bargain in connection with each of the properties could be assumed to be equal, whereas here it plainly was not. The dictum (Pet. 28) in *Hunt* v. *Commissioner,* 82 F. 2d 668 (C. C. A. 5th), likewise gives no support to the taxpayer's contention. There half or practically half of the corporation's stock had been issued for cash, and the other half was issued in exchange for machinery. If the value of the machinery had been known, the value of the whole stock issue could have been ascertained, and half of that value could have been allocated to the machinery. The record then would have shown the very factors missing here—the total value of the assets received for the stock, and the fraction of the stock issued for the machinery.

For lack of the same essential factors the Board

of Tax Appeals decisions cited by the taxpayer (Pet. 19–24) are inapplicable.

2. The taxpayer contended below that it was entitled to a credit under Section 26 (c) (1) of the Revenue Act of 1936 (Appendix, *infra*, p. 17) on the ground that it was prohibited from paying a dividend by the express terms of a written contract executed by it prior to May 1, 1936, relating to dividends. The Board of Tax Appeals rejected the contention, holding (R. 502) that neither the taxpayer's amended certificate of incorporation nor its preferred stock certificates relied upon by the taxpayer (see Pet. 8) were a contract within the meaning of Section 26 (c) (1). The Circuit Court of Appeals rejected the contention in part; the stock certificates and certificate of incorporation, it held (R. 542–543), could be a contract, and insofar as they required payments into a sinking fund for retirement of preferred stock before any dividend could be paid on the common, they constituted a contract prohibiting the payment of dividends and entitling the taxpayer to a credit under Section 26 (c). The court held, however, that insofar as the stock certificates and certificate of incorporation required the payment of dividends on the preferred stock before dividends could be paid on the common, they did not prohibit the payment of dividends but merely provided for priorities in their payment (R. 565).

Plainly an agreement as to priority in payment of dividends is not a contract prohibiting the payment of dividends, and the Circuit Court of Appeals was correct in so holding. It is true that the decisions below and that in *Lehigh Structural S. Co.* v. *Commissioner*, 127 F. 2d 67 (C. C. A. 3d), are in conflict with *Warren Tel. Co.* v. *Commissioner*, 128 F. 2d 503 (C. C. A. 6th), certiorari denied, 317 U. S. 697 (Pet. 12–13), but that conflict cannot advance the taxpayer's case. The Sixth Circuit's decision holds that a preferred stock certificate is not a contract under Section 26 (c), and if that were followed here the taxpayer would lose even the credit which it receives under the decision below (R. 542–543, 565).

The conflict upon which the taxpayer relies already existed at the time certiorari was applied for in the *Warren Telephone* case. The Commissioner resisted the petition there because the *Warren Telephone* case was correct independently of whether the stock certificate was a contract. The provisions involved there were like the provisions here; they merely required priority in the payment of dividends. The Commissioner also resisted on the ground that the question was no longer of great importance. The pertinent statutory provisions appeared only in the Revenue Act of 1936, applicable to 1936 and 1937, and their seriousness has been abated in a large degree by the retroactive relief provisions in the amend-

ments to the Revenue Act of 1936 by Section 501 of the Revenue Act of 1942, c. 619, 56 Stat. 798. We see no further reason here why a writ of certiorari should be granted.

3. The petition (Pet. 8; cf. Pet. 14) presents no other question for review. However, the taxpayer urges error (Pet. 10, 14) in the failure of the courts below to hold that the taxpayer's redemption of 68,572 of its preferred shares held by Schroder amounted to the payment of a taxable dividend to the extent of $12.25 per share, for which the taxpayer was entitled to a dividends paid credit under Section 27 (f) of the Revenue Act of 1936. The point was disposed of by the Board adversely to the taxpayer (R. 519). It was not mentioned in the original opinion of the Circuit Court of Appeals (R. 540–554) and it was not urged by the taxpayer in its petition for rehearing (R. 555–562). The petition for certiorari states no reasons for regarding the Board's disposition as erroneous, and the question, in any event, turns upon an analysis of the facts of the transactions in 1935 and 1936 between the taxpayer and Schroder, and has no general importance.

The Circuit Court of Appeals remanded (R. 544–546) the case to the Tax Court for findings of fact appropriate to a determination of the applicability of Section 26 (g), added to the Revenue Act of 1936 by Section 501 (a) (3) of the

Revenue Act of 1942. That provision had not become law at the time the case was heard in the Board of Tax Appeals (Pet. 6, 9) and the remand was appropriate. If Section 26 (g) is applicable to the present case under the findings to be made by the Tax Court, the entire deficiencies here involved may be expunged, and the importance of the questions presented upon this petition is accordingly minimized. In any event, the question stated by the taxpayer as to the constitutionality of the undistributed profits tax in this case (Pet. 3) cannot arise until the Tax Court has determined whether there is any deficiency.

CONCLUSION

The petition presents no conflict on any question which can affect the taxpayer's case, and the petition presents no other reason for certiorari. The petition should therefore be denied.

Respectfully submitted.

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APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 26. CREDITS OF CORPORATIONS.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

* * * * *

(c) *Contracts Restricting Payment of Dividends.*—

(1) *Prohibition on payment of dividends.*—An amount equal to the excess of the adjusted net income over the aggregate of the amounts which can be distributed within the taxable year as dividends without violating a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the payment of dividends. If a corporation would be entitled to a credit under this paragraph because of a contract provision and also to one or more credits because of other contract provisions, only the largest of such credits shall be allowed, and for such purpose if two or more credits are equal in amount only one shall be taken into account.

* * * * *

(g) [as added by Section 501 of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Stock Redemption Credit.*—An amount equal to the portion of the recognized gain, realized within the taxable year and prior to March 3, 1936, from the sale or other disposition of a capital asset, which, pursuant to a contract, was distributed prior

to such date to shareholders in redemption in whole or in part of preferred stock and which is not otherwise allowable as a credit under any other provision of this section or section 27.

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges Solely in Kind.*—

* * * * *

(5) *Transfer to corporation controlled by transferor.*—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(8) *Property acquired by issuance of stock or as paid-in surplus.*—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction

described in section 112 (b) (5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), * * *

* * * * *

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

* * * * *

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